

DATE: August 12, 2002

TO: Brett Dahl, Administrator

FROM: Kristie Rhodes, Risk Finance Specialist

RE: 2001 Cost of Risk/Benchmark Analysis

The 2001 Cost of Risk Benchmark Analysis is complete. The 2001 RIMS Benchmark Survey is the third study conducted by Ernst & Young LLP, one of the world's leading professional services organizations for RIMS (The Risk and Insurance Management Society, Inc.), a not-for-profit organization dedicated to advancing the practice of risk management.

The 2001 survey was completed by 837 respondents. 70 of the respondents were government entities, the largest group in this year's survey, against which RMTD is measured in this analysis. Revenue size could not be compared with that of other industries because respondents used a net operating budget as their primary exposure base. Most of the larger respondents in the government group (defined as those with operating budgets greater than \$1 billion) are state governments, large cities, and very large counties. The State of Montana falls into this category with an operating budget of over \$4 billion.

The total cost of risk and composition of the cost of risk dollar statistics presented in this report, as well as the data displayed in charts and graphs were obtained from the 2001 RIMS Benchmark Survey, RMTD FY2001 SABHRS reports, Office of Budget and Program Planning and the State Fund. This benchmark schedule compares Montana to other governmental respondents and uses the governmental industry median numbers presented in the survey.

Due to the terrorist attacks of September 11, 2001, and the significant insured loss expected by underwriters, the insurance market, at the time the survey was written, was in a state of flux. Since the results summarized in the 2001 RIMS Benchmark Survey are a reflection of the participant's experience in 2000, users of the survey are likely to find it difficult to benchmark post-September 11, 2001 costs with those found in the survey. It is important to follow industry trends to better determine the effects of September 11, 2001.

#### Total Cost of Risk

The total cost of risk in the survey is measured by the sum of:

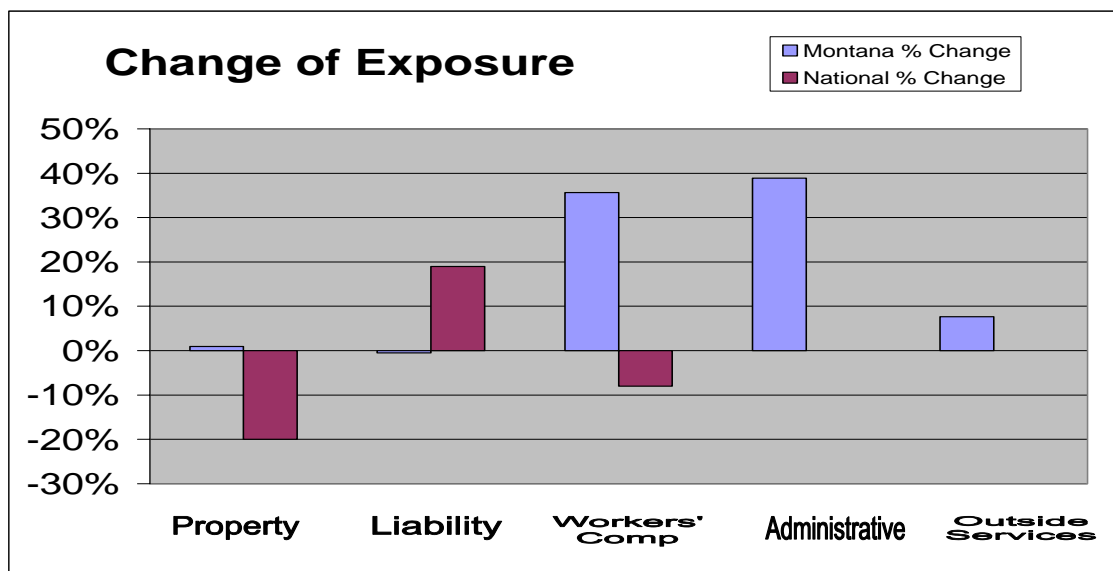
- 1) Insurance premiums for liability, property, and workers' compensation collected by the Risk Management & Tort Defense Division and the Montana State Fund;
- 2) Risk management/insurance department administrative budgets; and
- 3) Costs for outside services such as actuarial fees.

The term “cost of risk” refers to all costs associated with an organization’s risk management functions—namely, net insurance premiums, retained losses, risk control, and loss prevention expenses, and administrative costs.

In 2000, the average cost of risk for all U.S. respondents reached its lowest point in over a decade, driven by lower premiums and lower retained property and workers’ compensation losses per \$1000 of revenue. The average cost of risk for all U.S. respondents (except banks) is \$4.83/\$1000 of revenue. Government entities also experienced a decrease from the previous year, which was a result of lower workers’ compensation and property costs. Montana did not follow the government entity trend, Montana’s total cost of risk increased 18% from FY2000. Montana’s total cost of risk in FY2000 was \$12,969,045 and \$15,242,485 in FY2001. The main factor contributing to the increase is a \$1,976,343, or 36% increase in workers’ compensation costs. Montana’s property and liability costs held constant from FY2000 to FY2001 while nationally the liability cost of risk increased 19%. There was also a significant increase in administrative services. The schedule below illustrates changes by exposure for Montana’s total cost of risk.

				<b>Montana</b>	<b>National</b>
<b>Exposure</b>	<b>FY2000</b>	<b>FY2001</b>	<b>Change</b>	<b>% Change</b>	<b>% Change</b>
Property	\$1,393,782	\$1,406,669	\$12,887	1%	-20%
Liability	\$5,139,263	\$5,114,255	(\$25,008)	0%	19%
Workers' Comp	\$5,540,818	\$7,517,161	\$1,976,343	36%	-8%
Administrative	\$769,873	\$1,069,541	\$299,668	39%	0%
Outside Service	\$125,309	\$134,859	\$9,550	8%	0%
<b>Totals</b>	<b>\$12,969,045</b>	<b>\$15,242,485</b>	<b>\$2,273,440</b>	<b>18%</b>	

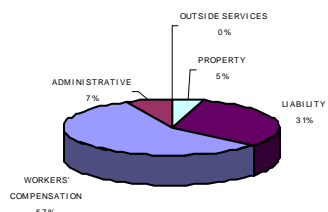
The survey shows that for all respondents nationally, the only increase was in liability costs. Montana’s cost did not follow the national trend in any exposure by increasing in all areas except liability costs. See the comparison graph below.



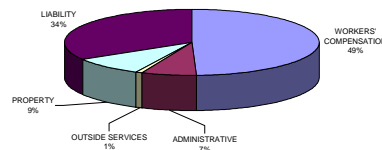
## Composition of the Cost of Risk Dollar

The composition of the cost of risk dollar shows what percentage of each risk dollar is spent on each type of exposure. The following pie charts and bar graph compare the State of Montana to other governmental entities participating in the survey.

National Composition of Cost of Risk Dollar

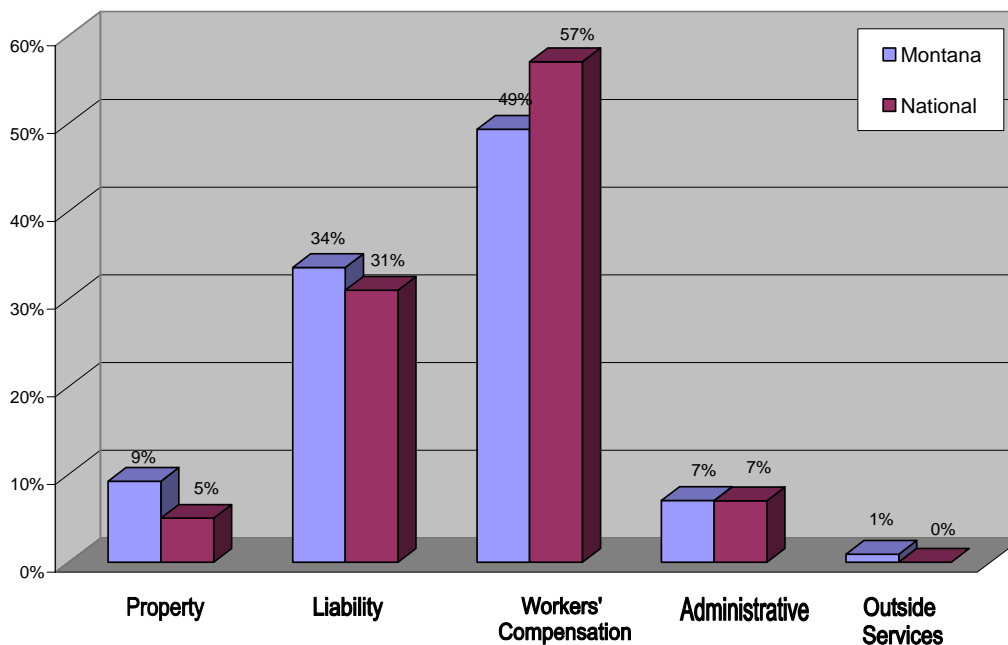


Montana Composition of Cost of Risk Dollar



Montana, similar to other government entities, spends approximately half of its cost of risk dollar on workers' compensation. Although Montana decreased the liability portion of the cost of risk dollar from 40% to 34% from 2000 to 2001, other government entities increased from 21% to 31% in the same period, therefore Montana is not following the trend. Montana spends 4% more

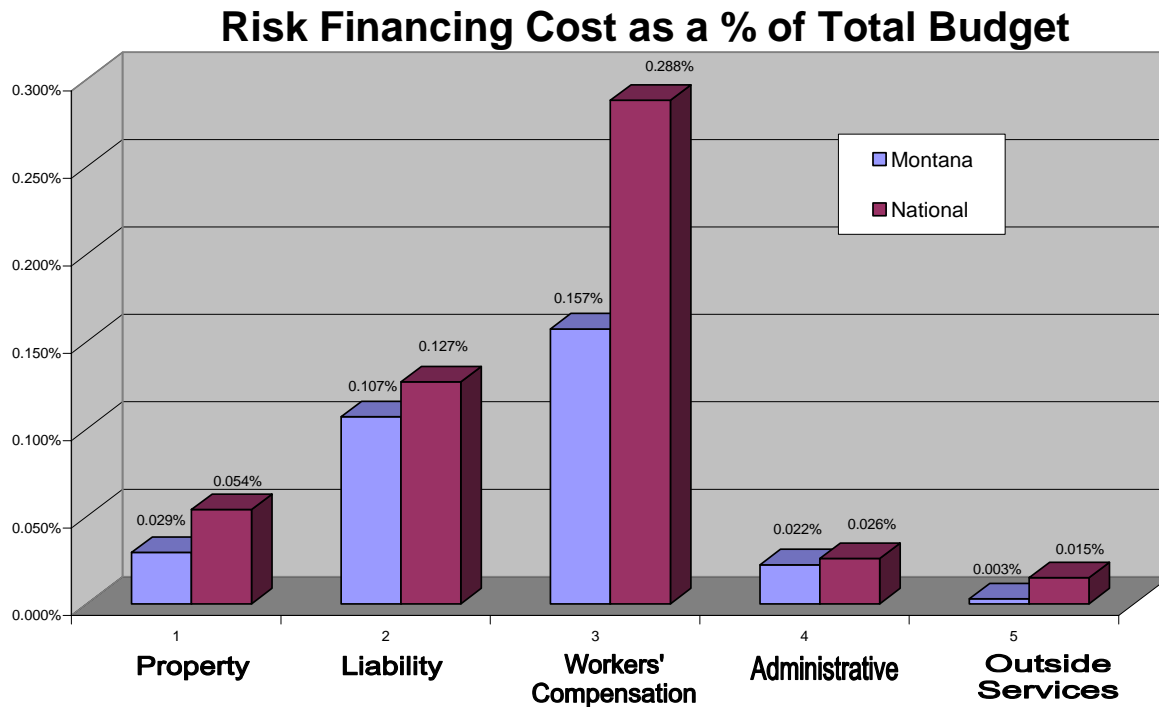
## Composition of Cost of Risk Dollar



on property than its cohorts. Montana spends 1% of their cost of risk dollar on outside services and 7% on administration, which is similar to other government respondents.

### Risk Financing vs. Total Budget

The bar graph below compares the risk financing cost as a percentage of the total State of Montana operating budget to other government entities. The graph shows that Montana spent less of their total budget on cost of risk exposures in all categories. Montana's risk cost as a percentage of the entire state budget, including the university system, is only 0.319%, down from 0.362% in 2000. Nationally, government agencies are using 0.633% of their operating budgets on the cost of risk.



### Summary

As with any study, one has to be careful in drawing conclusions and recognize the limitations of the underlying data. The survey is based on questionnaire information presented to a variety of different entities and does not include data related to the September 11, 2001 terrorist attacks. Each of these entities uses different data gathering techniques and assumptions, as well as having different operating objectives. The survey, however, is the best source of information currently available from which to draw conclusions. This year's questionnaire received more responses from large entities with more than \$10 billion in revenues, which contributed to a decrease in the national cost of risk for all respondents. This group, which accounted for around 57% of total respondent revenues this year has a very significant influence on weighted average results because of their extremely large size. While costs did increase and decrease among different revenue-size groups, the median cost of risk declined from last year. For all respondents,

property and workers' compensation costs decreased but liability costs increased. The consensus of survey respondents was that the insurance market was hardening with less competitive renewals in 2000 and E-business risk was of low concern to risk managers nationally.

Montana's total cost of risk has continued its declining pattern, primarily due to the reduction in liability costs. In FY2001, we spent more of our cost of risk dollar on property and liability costs than the survey shows other governmental entities spend, and spent less of our dollar on workers' compensation exposures.

Montana is also consistent with close to one-third of larger respondents who do not purchase commercial general liability and workers' compensation insurance but do purchase commercial property insurance.

In terms of the amount spent on exposures as a percentage of the total budget, Montana spent less than the other governmental entities in the survey in every category measured. Overall, Montana spent 0.319% of the total operating budget on cost of risk and their counterparts spent 0.633% of their total budget on cost of risk last year and historically Montana has spent less, as illustrated in the chart below.

**Historical Cost of Risk**

